

June 12, 2002

**NATIONAL COMMISSION TO ENSURE CONSUMER INFORMATION
AND CHOICE IN THE AIRLINE INDUSTRY**

STATEMENT OF GALILEO INTERNATIONAL

Galileo International appreciates the opportunity to provide its views to the National Commission to Ensure Consumer Information and Choice in the Airline Industry. Galileo, a subsidiary of Cendant Corporation, operates a leading global distribution services company that provides extensive airline, rental car, hotel, tour, and cruise information and booking and ticketing capabilities to approximately 45,000 travel agency subscribers located in 115 countries. Galileo, which has approximately 2,300 employees, has its principal domestic offices in Denver, Colorado, Rosemont, Illinois, and Parsippany, New Jersey. Through its computerized reservations system ("CRS"), Galileo serves thousands of travel agency locations in the United States.¹ Galileo subscribers can access flight availability and fare information for approximately 500 airlines, as well as information on services of many other travel suppliers. Galileo is a neutral provider of travel information with a vested interest in the success of all travel industry participants, including travel agents and travel suppliers, as well as the traveling public.

¹ Galileo offers CRS services through its Apollo® CRS within the United States and through its Galileo CRS in most countries outside the United States (collectively referred to as "Galileo" or the "Galileo system" below).

This Statement will first discuss specific types of support Galileo provides to the travel industry. Next, it will address important economic issues currently under discussion within the industry, including the availability of so-called "Web fares" and the level of CRS fees. Finally, this Statement will address the subject of CRS regulation and its impact upon the travel agency community and consumers.

Galileo's Support Of The Travel Services Industry

CRSs provide travel agents, airlines, and other travel suppliers with a highly efficient tool to manage millions of pieces of constantly changing travel information. As the American Society of Travel Agents recently told the Department of Transportation, "the scope of total information available through CRS is unequaled by any other technology."²

Galileo is proud to have been one of the originators of the systems that provide automated travel booking services to travel agencies on behalf of airlines. In the early 1970s, prior to the introduction of CRSs, travel agents had to rely on the telephone and on paper copies of the Official Airline Guide and other manuals to obtain information on flights and fares and to book flights for their customers. The introduction of CRSs allowed travel agents to obtain airline information and book flights electronically, allowing them to better serve their customers with increased efficiency. Over the years, CRSs became the key

² See *American Society of Travel Agents, Inc. and Hillside Travel, Inc. v. Delta Airlines, Inc., et al.*, Docket No. OST-2002-12004, Complaint filed March 28, 2002, at ¶ 14.

distribution vehicle for the travel industry. CRSs gave travel agents the ability to communicate instantly on a world-wide basis with a myriad of travel suppliers. As airlines expanded their service and fare offerings following deregulation, CRSs allowed travel agents to keep up with the explosion of information, providing consumers with the full range of new travel options. The pace has accelerated over time. In just the last few years, as airlines fine tune their yield management strategies, the volume of fares has increased dramatically. CRSs allow travel agents to access efficiently the huge amounts of information on airline and other travel services.

During the past 25 years, Galileo has invested hundreds of millions of dollars to add new features and improve the capabilities of travel agents and travel suppliers. Galileo has repeatedly upgraded the hardware it provides to travel agencies, its huge computer database located in Denver, Colorado, where supplier data is managed, and the vast communications network linking travel agents to that database and to the suppliers. Among other things, Galileo added direct links to the internal computers of airlines and other travel suppliers, so that travel agencies can access real time information on flight and fare availability and can make bookings with virtually instantaneous confirmation.

Over the years, Galileo has been a strong partner with both the airline industry and the travel agency community. To benefit airlines, Galileo has added a host of new features, including inside availability, seat maps, interactive sell, interactive seating, marriage logic, alliance displays, electronic ticketing, and many others. All these features help airlines to function more efficiently.

As to travel agencies, Galileo has worked with its travel agency subscribers to help define their needs and provide products and services that assist them in building their businesses. For example, Galileo's graphical user interface desktop software, known as Viewpoint, allows agents to book reservations with the click of a mouse, access a centralized customer database, and much more.

One of the most significant steps Galileo has taken to help agencies manage their businesses was the granting of broad access to Galileo's system architecture and data platforms. This allows agencies greater access to the CRS data and allows third party developers to create new products designed to help agencies succeed. For example, XML Select allows agencies to create high-volume, Web-based booking engines and server-based applications. In addition, Galileo offers travel agents access to TravelGalileo.com, which allows agencies to develop and enhance their own websites. Also, through Galileo's recently announced Web Services, travel agencies can deliver travel and booking information to their consumers faster at a significant cost savings.

Airline commission caps and cuts and now complete elimination of commissions have driven agencies to look for new ways to generate income. Galileo has developed solutions that allow travel agents to use the Internet to support new opportunities and enhance the sales process. With Galileo's e-Agent feature, travel agents can quickly navigate travel-related websites to offer additional services for their customers.

As another example, a Galileo subsidiary offers Agentflash, an on-line system that provides travel agencies with marketing information generated from booking data gathered from the Galileo system. This tool allows travel agencies to better manage their override agreements with airlines and otherwise monitor their own performance.

Galileo has devoted special attention to the needs of small and medium sized travel agencies through a network of support entitled the Small Business Accounts Management region ("SBAM"). Last year the SBAM team developed a productivity appraisal service designed exclusively for smaller agencies to help them use the many Galileo product solutions that are available to them. By providing an evaluation of travel agents' skills, knowledge, and use of the Galileo system, we help them to maximize their agency's productivity and revenue. The analysis is broad-based and includes an examination of work flow processes, business policies and procedures, service fee structures, preferred vendor programs, personnel management, Passenger Name Record analysis, and training opportunities. Galileo provides the agency with a 50-page report that identifies where productivity and efficiency gains can be made.

In addition to providing travel agents with an extensive range of services to enhance their productivity, Galileo offers them significant financial support. Galileo supplies many of its subscribers with computer hardware free of charge. In some cases Galileo provides additional financial incentives. These incentives can be sizable in cases where an agent books a large volume of transactions through the Galileo system.

In recent years, Galileo has observed significant deterioration in the financial condition of the travel agency business. This has been due in significant part to the major airlines' decisions to cut back on the commissions they pay to travel agents. As agents have earned less money from commissions, they have turned to Galileo and other CRSs to help make up the difference. Galileo's "commission costs," which include incentive payments to travel agencies, amounted to over \$700 million in the year 2000. Commission costs are currently Galileo's largest operating expense,³ and these costs continue to rise. Galileo (and other CRSs) provide additional assistance to agencies in order to help them remain competitive as they lose revenue from airlines.

Galileo constantly searches for ways to support the travel agent community. As one example, in the wake of the September 11 tragedy, when the entire travel industry came to a virtual standstill, Galileo was the first CRS to provide financial relief to the industry. This included waiving certain fees ordinarily charged to subscribers. Galileo made an across-the-board adjustment to all its travel agency contracts, giving full credit to all agencies for all targeted booking levels for September through December, or a flat reduction in booking targets for the year, despite the fact that booking levels dropped precipitously in this period. In essence, tens of thousands of agencies paid no lease fees for their computer equipment for this period. These adjustments afforded important financial relief to travel agents, particularly to smaller agencies that had few

³ Other operating costs, as reported in Galileo's Annual Report for 2000, amounted to \$614 million.

resources to fall back on. In total, Galileo provided millions of dollars in relief to the agency community in the aftermath of the September 11 tragedy.

In addition, Galileo recently introduced a flexible pricing program known as "Select and Connect," designed to help small agencies that generate fewer than 20,000 bookings per year. In early 2002 it became clear that the events of September 11, combined with the airlines' new zero base commission policy, was negatively impacting smaller agencies over the long term. Galileo's new Internet-based "Select and Connect" pricing program provides small agencies with a more cost-effective method of distribution while allowing them to earn revenues if they achieve certain booking targets. This new pricing program, which allows agencies to focus their efforts on servicing customers, has been well received by the marketplace.⁴

Web Fares

There is one important respect in which both travel agencies and CRSs have been disadvantaged by airline policies. This relates to the availability of so-called "Web fares," which are especially low fares that airlines offer only over the Internet. Travel agents and the consumers they serve have always benefited from the comprehensive information on airline services and fares that

⁴ The support Galileo provided to the travel agency community in 2001-2002 is nothing new. In 1999, Galileo announced a five-point plan to provide relief to travel agents following earlier commission cuts by the airlines. This plan included more flexible subscriber contract terms, enhanced customer service offerings such as group purchasing plans for equipment, and several new Internet-based alternatives designed to help brick and mortar travel agencies that wanted to provide on-line services to their customers.

Galileo and other CRSs have been able to offer. Now, however, the major airlines have chosen to make their Web fares available only on the airlines' individual websites and through Orbitz, an on-line travel distribution system owned by five major airlines. The airlines decline to make these highly desirable fares available through other outlets, including CRSs and the travel agents they serve. This practice is supported by various contractual arrangements between Orbitz and its airline members, including a most favored nation provision, a requirement that Web fares be provided to Orbitz, and certain financial contribution requirements.

Galileo and travel agents have attempted to persuade air carriers to make all of their fares, including Web fares, available through the Galileo system in a cost-effective manner, with very little success. As a result, Galileo's travel agent subscribers cannot access these fares through normal channels. In turn, consumers who choose to use a travel agent to make their flight arrangements miss out on these fares. Importantly, there are certain consumers who do not have access to the Internet and therefore are unable to take advantage of the low Web fares. These consumers, generally the poor and the elderly, are least capable of affording higher airline fares. In essence, as a result of the airlines' restrictive policies, this group of consumers has been disenfranchised from the lowest fares offered by the airlines.

Thus, in the short run travel agents cannot provide the best service and consumers are disadvantaged because they do not obtain complete information about important travel options. In the long run, the lack of access to Web fares will make travel agencies less competitive. Ultimately, even if they

would prefer to use a travel agency, fewer and fewer customers will do so because they will question agencies' ability to provide them with low Web fares.

Travel agents cannot compete effectively if a single entity such as Orbitz maintains proprietary access and monopolistic control over the lowest fares. If CRSs continue to be shut off from access to these fares, consumers will suffer as their options are reduced. Furthermore, over time travel agents (especially the small ones) will inevitably go out of business. Indeed, thousands already have in the last year and a half.⁵

Orbitz has attempted to defend its exclusive access to Web fares by claiming that large increases in fees the CRSs charge to airlines are responsible for the airlines' decision to limit the availability of these fares.⁶ This attempt to cast the blame on CRSs is clearly misguided; in fact, it constitutes an effort to deflect attention from the anticompetitive strategy the airlines are following through Orbitz. Galileo wishes to set the record straight.

⁵ Airline Reporting Corporation data indicate that the number of U.S. travel agents has dropped by more than 3,000 since the end of 2000; within just the first four months of 2002 the number of agents dropped by more than 1,000.

⁶ Orbitz has leveled such charges on various occasions, including in its recent testimony before the Subcommittee on Regulatory Reform and Oversight of the House Small Business Committee and in its answer to a complaint filed by the American Society of Travel Agents before the U.S. Department of Transportation, in Docket No. OST-2002-12004.

Among other things, Orbitz has claimed that CRSs have monopoly power, but Galileo obviously has no monopoly on travel information and travel booking and ticketing services. In addition to three other CRSs operating in the United States, there are numerous services offering automated booking and ticketing capabilities, including individual airline websites and on-line travel services such as Travelocity, Expedia, and Orbitz. Nor is participation in every CRS "essential" to an airline. Neither Southwest nor JetBlue participates in the Galileo system.

Orbitz has provided few specifics to support its claims about CRS fees. The fact is that over the past 17 years the basic fee for the simplest booking transaction in the Galileo system has hardly increased at all. In late 1984, after regulations governing CRSs were put into place, the basic Galileo segment fee was \$1.85. Today, for the same simple transaction, the segment fee is \$1.95. This comparison reveals that, when inflation is taken into account, Galileo's fees have actually declined in real terms for the basic booking transaction.

Of course, much has changed since 1984. Over the years Galileo and other CRSs have added sophisticated functionality that provides airlines with a far higher level of service than the basic service available 17 years ago. Rather than buying a basic service, most airlines today are buying premium services. Not surprisingly, these more sophisticated services are more costly.

A fair comparison here is the increase in the price of automobiles during the same period. Just as CRS technology has improved dramatically over the years, so has technology in the auto industry. In 1984, a basic Chevrolet Camaro listed for \$8,000. Today's premium Camaro lists for approximately \$25,000, but it is a far more advanced product than its 1984 counterpart. The sophisticated technology in today's cars was not even contemplated 17 years ago. The same is true for CRSs. CRSs are more advanced, and airlines are purchasing higher cost CRS functionality that was not available in 1984.

The airlines' decisions to take advantage of the technological advances in CRSs and to purchase premium services result in a fee that is higher than the basic fee charged in 1984. For example, in a common scenario, a reservation in the Galileo system is booked, then cancelled, rebooked, and

ticketed. The booking fee for those services would be between \$3.72 and \$4.32 per segment depending on the premium services selected by the airline.⁷

Particularly in view of the sophisticated functionality provided today, the booking fees Galileo charges to airlines are entirely reasonable. Galileo and other CRSs provide extremely valuable services to air carriers, allowing them to save millions of dollars in promotional and reservations staff costs.

Orbitz has asserted, without support, that CRS costs have decreased and that CRSs therefore should have reduced their fees to airlines. Galileo's costs, however, have increased. While some types of computing and telecommunications costs may have fallen over time, many Galileo costs, including hardware, development, personnel, and marketing costs, have increased very substantially. As one example, the cost to employ and retain skilled computer technicians has increased dramatically. Furthermore, the CRS business requires continuous investments to develop new functionality and upgrade the vast, highly sophisticated network that supports the systems. CRSs must spend hundreds of millions of dollars each year to maintain the huge databases and communications infrastructure that make CRS services possible, and to develop new features (e.g., electronic ticketing capabilities for airlines) that enhance the capabilities of both travel agencies and airlines, and provide

⁷ The fee for booking a simple Web fare, which ordinarily involves a single reservation without changes, would be far less – ranging from \$1.95 to \$2.35 per segment, depending on the service level chosen.

tremendous conveniences for the traveling public. CRSs must earn revenues sufficient to cover these huge investments.

Simply keeping up with the increasing complexity of airline operations requires CRSs to make very substantial investments. As noted above, over the last few years there has been an explosion in the number and complexity of fares submitted by airlines, as the airlines implement increasingly sophisticated yield management strategies. In order to handle the additional volume and complexity of fares, Galileo in the year 2001 installed 24 new processors at a cost of millions of dollars.

Galileo has moderately increased the booking fees it charges to airlines in order to meet increased costs. There is no reason to conclude that travel agents, rather than airlines, should cover those costs. Indeed, in this regard it is important to note that it has been the airlines (not the CRSs and not the travel agents) that have driven up costs by creating ever-increasing and ever more complex fare rules. The airlines have done so for their own economic self-interest and should not now complain about the consequences.

Moreover, contrary to Orbitz's suggestion, the impact of Galileo's fees on the finances of airlines has not increased. Galileo's average booking fee has remained constant as a percentage of the average airfare. In 1992, the Department of Transportation noted that the average CRS booking fee was "somewhat more than two percent of the average ticket price per segment." 57 Fed. Reg. 43817 (1992). Galileo estimates that its current average booking fee is approximately two percent of today's average air fare. Thus, there is no basis for any suggestion that CRS services are placing a greater burden on airlines,

that travel agents should pick up more of the cost so that airlines pay less, or that the CRS booking fees that airlines pay force airlines to move business away from travel agents.

CRS booking fees are in fact proportionally less than the processing fees charged for much simpler transactions in other industries. Telecharge and Ticketmaster charges are in the range of \$8 to \$9 per transaction.⁸ Thus, for a \$40 ticket, the purchaser could pay processing fees of close to 25 percent of the face value of the ticket. Charges for withdrawal of cash from an automated teller machine can be as high as \$3 per transaction.⁹ Thus, for a \$20 withdrawal the customer could pay a fee amounting to 15 percent of the amount received. The two percent of revenue paid by airlines for far more complex CRS booking services is plainly a bargain.

So far as Galileo can determine, Orbitz's claim that it offers lower distribution costs than CRSs is incorrect. Based on available information, Galileo understands that Orbitz passes on to its airline customers a fee it has negotiated with Worldspan (a CRS that Orbitz uses as its booking engine) and also charges a service fee to the carrier in connection with each booking.¹⁰ As reported by Travel Weekly, the resulting Orbitz distribution cost is approximately \$14 for an

⁸ See J. Zink, "Reviews of New Shows On and Off Broadway," Sun-Sentinel, March 10, 2002, p. 4D (Telecharge imposes \$6 service charge per ticket, plus a \$2.50 handling fee per order; Ticketmaster imposes a \$6 service charge per ticket, plus a \$3 handling fee per order).

⁹ See "ATM Fees Earn Chicago 2nd City Label," Chicago Tribune (Chicago Sports Final Edition), Aug. 4, 2000, p. 1 (median ATM charge in Chicago and Washington, D.C. areas is \$3; median charge nationally is \$2.25).

¹⁰ See D. Schaal, "Sabre: Orbitz No Longer the Low-Cost Channel," Travel Weekly, April 15, 2002, p. 10. A copy of this article is attached to this statement.

average trip of 2.5 segments with no reservation changes, far higher than the Galileo fee of approximately \$5.83 for the same average trip of 2.5 segments -- a premium booking that is ticketed.¹¹ Thus, Galileo's fees are approximately \$8.00 less than Orbitz's fees in that example. Galileo's advantage presumably would be even greater in the case of a simple Web fare, which ordinarily involves only a single reservation with no changes. For that sort of booking, the Galileo fee would range between \$1.95 and \$2.35 per segment, depending on the premium services selected by the airline.

Thus, there appears to be no basis for Orbitz's claim that the airlines' decision to supply Web fares only to Orbitz and to deny them to CRSs and travel agents is due to the higher cost of CRS distribution. Because Orbitz is apparently the higher cost distribution option, if cost were really the motivating factor, airlines should be more willing to list Web fares on Galileo than on Orbitz. In view of the relative costs, it is difficult to understand why air carriers decline to offer their special fares through the CRS distribution channel (at least through the low-cost Galileo channel), while providing them through Orbitz, unless they perceive a long-term strategic benefit from directing bookings to their jointly-owned system. On the face of it, it appears that the airlines' failure to provide Web fares to distribution channels other than Orbitz has little to do with cost and

¹¹ See *id.* In order to argue that it has a distribution cost advantage, it appears that Orbitz adds the cost of override commissions paid to travel agents in its computation of costs of selling through a travel agent. See Answer of Orbitz, L.L.C., filed April 29, 2002, at 7 n.2, in U.S. Department of Transportation Docket No. OST-2002-12004. Of course, carriers offer override commissions voluntarily in order to gain more business; such costs are not "imposed" by CRSs or travel agents.

much to do with control. Based on what Galileo has observed, air carriers appear to be seeking to provide special preference to their own system, Orbitz, in the hope that it will ultimately displace other forms of distribution.

If the airlines succeed in shifting large amounts of business away from travel agents and into the Orbitz channel, the travel agent community will experience even greater financial distress. As travel agents close their doors, consumers will lose the opportunity to choose to have experienced professionals handle their travel arrangements. Once exploited, the airlines' stranglehold on the distribution of low fares will result in higher costs to the traveling public.

CRS Regulation

CRS rules, now administered by the U.S. Department of Transportation, were promulgated in 1984 in order to redress abuses by the airlines that were the sole owners of CRSs at that time. The Civil Aeronautics Board found then that the airline "system owners" were using the CRSs in an anticompetitive fashion, to the detriment of consumers and airline competition. The CRS rules have proven largely effective in eliminating the conduct that originally gave rise to concern.

Today, the airlines are re-creating on the Internet the same anticompetitive strategy that initially prompted promulgation of the CRS rules almost 20 years ago. The government must again step in to regulate such conduct by the airlines in order to promote airline competition, preserve the ability of travel agencies to compete and to provide a full range of information to their customers, and reduce consumer costs.

Currently, the CRS rules do not extend to services provided directly to consumers over the Internet. The Department of Transportation should add provisions that regulate use of the Internet by airlines that own/operate/market on-line travel services.

As described above, provisions of the Orbitz airline participation agreements are having an anticompetitive effect in the marketplace. Air carriers' practice of withholding discount Web fares from competitors of Orbitz is denying valuable information to travel agencies and their customers, reducing consumer choice, and restricting the availability of low fares. The Department of Transportation should prohibit airlines from agreeing among themselves, through most favored nation provisions or otherwise, to make fares available only through airline-controlled ventures. Each airline should be free to act unilaterally to offer fares to competing websites without being required to give the fares to an airline-owned consortium.

CONCLUSION

In conclusion, Galileo endorses measures to strengthen the financial viability of travel agents and to ensure that agents can provide the full range of travel options to consumers. Travel agents should have the opportunity to compete on a level playing field. Air carriers should not enter into agreements that result in denying CRSs and travel agents access to important fare options. Rather, each individual airline should be free to act unilaterally to offer fares to other on-line services and CRSs without being required to give the fares to an airline-owned consortium pursuant to a multi-airline agreement.

Galileo urges the Commission to recommend that Congress and the Department of Transportation take steps to ensure that CRSs, the travel agents they serve, and the consumers who choose to use the professional services of travel agents have access to all fares offered by air carriers. Maximizing such access is the best way to ensure the existence of consumer information and choice in the airline industry.

Galileo thanks the Commission for the opportunity to present its views. If the Commission or any of its members wishes further information, we invite you to contact Cathy Cupp, Senior Vice President and General Counsel of Galileo, 9700 West Higgins Road, Suite 400, Rosemont, IL 60018, phone no. 847-518-4750.

ATTACHMENT

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